# CHAPTER IV

## THE MANY FACES OF CUSTOMER CHOICE:

## Aggregation And Group Buying Power

Individual customers will be able to participate in competitive electric and gas markets in several ways. The most common is referred to as "direct access." In this approach, customers enter into a bilateral contractual relationship with their chosen electric or gas supplier. The contract governs services, terms and conditions, and fees associated with provision of these services. Even though a distribution company may act as the billing agent for the supplier, the rights and remedies of the customer and the supplier will be established in the contract between them.[48] This chapter of the *Blueprint* addresses how the state may stimulate and regulate alternative approaches to electric competition that enhance its benefits to residential customers. These approaches, however, are not viewed as substitutes for consumer protection policies identified elsewhere in this document.

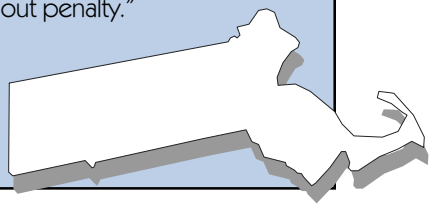
An alternative to direct access is a form of group buying that is generally referred to as "aggregation."[49] Under this approach, the customer enters into a relationship with an entity that acts as a middleman between him/her and the retail energy supplier. The entity may be a political subdivision, such as a municipality or county, or a national, state, or local organization that seeks to obtain energy and other products on behalf of its members. Aggregation may be based on geographic location or non-geographic criteria, such as membership in a group, or employment. In some states, efforts

### Excerpt from Massachusetts legislation:

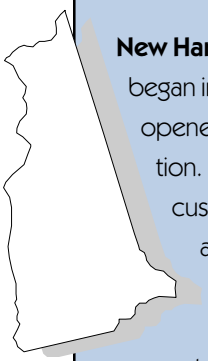
"Following adoption of aggregation through the votes specified above, such program shall allow any retail customer to opt-out and choose any supplier or provider such retail customer wishes.... Nothing in this section shall be construed as authorizing any city or town or any municipal retail load aggregator to restrict the ability of retail electric customers to obtain or receive service from any authorized provider thereof.

It shall be the duty of the aggregated entity to fully inform participating ratepayers in advance of automatic enrollment, that they are to be automatically enrolled and that they have the right to opt-out of the aggregated entity without penalty. In addition, such disclosure shall prominently state all charges to be made and shall include full disclosure of the standard offer rate, how to access it, and the fact that it is available to them without penalty."

Section 247, adding Section 134 to Chapter 164.



are underway to create non-profit entities which aggregate the sale of electricity and energy management services to residential or low-income residential customers. Aggregation in particular is often viewed as a way to stimulate creation of a competitive market for low-use customers who may not otherwise be the target of marketing efforts by energy suppliers.



**New Hampshire's** electric pilot program began in April 1997, when the state PUC opened 3% of the state to competition. Half of the participating customers were picked by lottery and half participated by virtue of their location. Called "Geographic Areas of Choice," certain municipalities were chosen as targets for competition. These municipalities were allowed to determine how suppliers would be selected and how residents would be recruited to participate. When Peterborough, N.H., solicited proposals, 13 energy suppliers responded. Four public hearings were held. Once the supplier was selected, each citizen had to affirmatively choose to receive electricity from the winning bidder. Out of 5,000 residents, 1,400 actually participated. The resulting two-year, fixed-price contract was estimated to save participants 15-20% on their electric bill. The winning supplier also contributed $25,000 to the town's economic development fund.

## Consumer Benefits From Aggregation

Both customers and power suppliers may benefit from aggregation:

- Low-use residential and small business customers may not benefit from direct access because their usage characteristics, coupled with a lack of advanced metering systems, may make them expensive to serve. Marketing costs to reach and consummate deals with these customers may exceed profit potential on electricity sales alone, unless the volume of sales is high. On the other hand, if a power supplier can negotiate one sale with an entity that represents a large group of customers with a similar energy profile, without incurring upfront marketing costs, lower prices may result.

- If Default Service is based on the market price or is priced below market rates by regulators, individual residential customers may not find energy any cheaper in the marketplace. However, an aggregator may be able to offer other valuable services and products, such as energy management or even telephone service, in a package deal that is desirable to customers.

- Aggregation may improve the market power of residential and small business customers. The aggregator that can deliver a significant energy load can bargain for a lower price

and enhanced energy management services on behalf of group members.

- Aggregation may also be an important tool to achieve a state's Universal Service goals. In general, low-income customers use less energy than other residential customers. Furthermore, while most low-income customers do pay their bill, a high percentage of low-income customers cannot pay their electricity or gas bill in a timely manner because of its significant impact on household income (over 20% for some customers with higher-use and very low household income). Therefore, it is likely that low-income customers may need more customer service support, or carry a high risk of bad debt expense. Whether low-income customers should be the focus of aggregation efforts or whether they are better off in general as part of the residential class is a hotly debated topic among customer advocates. However, there is little debate about the notion that if suppliers do not market to residential customers in general, low-income customers will most likely be ignored.

## Barriers to Effective Aggregation

Advocates have sought to remedy several potential barriers to aggregation in state electric restructuring legislation. Should customers be required to "opt in" to be bound to a contract for the sale of electricity negotiated by a group or organization? Or should customers be presumed to be bound and have the option to "opt out"? In other words, should a customer be bound to a contract with the aggregator in the same way that a customer can be bound in a contractual relationship with a direct access supplier? Proponents of aggregation argue that for benefits to be realized, membership in the group should signify that customers approve the group's power supplier; cost savings, due to economies of scale, may then, in fact, be realized.

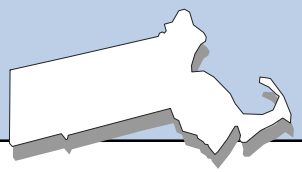
Membership rights and responsibilities may affect supplier bids; suppliers may not bid on a group contract if the number of ultimate customers is unknown. However, aggregation proponents note that the "opt out" approach has not been successful in most states. Only Massachusetts has adopted legislation which allows a municipality, after a detailed public process, to presume that their residents' power supplier will be switched to the town's selection unless the customer opts out of the program. California's legislation specifically requires individuals to opt in to an aggregation plan, including one proposed by their local municipality.[50] No state legislation

has allowed a private aggregator to group customers without specific affirmative approval from each customer in the group. This means that, for example, if the American Association of Retired Persons (AARP) seeks to aggregate customers in a state, the members who want to approve AARP's plan must *positively* approve it; membership alone will not suffice to presume supplier choice.

A second potential barrier to the use of aggregation, especially applicable in the municipal context, is the process a town must follow to solicit proposals and select a winning bidder. It is likely that in most states, a municipality will need legal authorization to initiate this type of activity. At the very least, the selection process requires public presentation of final bid offers, public meetings or hearings, and public comment and review of the town's proposed selection.

Municipalities and quasi-governmental agencies need to establish a framework within which an aggregation program is designed. This may present a third barrier. For example, Massachusetts requires that a municipality first devise an energy plan and establish criteria for selection of a power supplier. The state has also legislated minimum requirements for any municipal solicitation for power supply, which is designed to assure customer service and consumer protection provisions are not compromised for lower prices. A town may select a supplier on the basis of criteria that includes, but does not rely entirely on, price. This allows a municipality to choose a supplier that furthers environmental and energy efficiency goals, as well as price competitiveness. The town's plan and contract requirements may also be subject to approval by the state, which may impose additional requirements on the solicitation process.

**Massachusetts** legislation allows a town to run its own energy efficiency programs with a Systems Benefit Charge (up to 3 mills per kWh) and to directly invest (up to 1 mill per kWh) renewable energy funds in its own community.



In most states a private aggregator, doing business as an individual or an organization, must obtain a license to sell electricity and agree to comply with all appropriate state regulations. In other words, such issues as price and contract term disclosures, collection remedies, bill format, and other consumer protection procedures will also be applicable to contracts negotiated by aggregators. However, some state licensing requirements distinguish between suppliers and aggregators or brokers who do not take title to electricity. Such distinctions may impact requirements for bonding and other financial securitization. Substantial bonding requirements may act as a barrier for small non-profit groups attempting to provide aggregation services on behalf of its members.

The Consumer Electric Cooperative (CEC) proposes to deliver important services to low-income households, including

- aggregating the market power of low-income customers into larger groups for the purpose of negotiating better prices;
- delivering energy efficiency programs to reduce total bills; and
- pursuing bill minimization policies, such as switching customers from electric space heat to a less expensive fuel source.

## Consumer Energy Cooperatives

Energy advocates in Vermont are designing a full-service consumer-owned energy cooperative whose mission is to lower members' energy bills by combining competitive energy pricing with comprehensive energy services. Its proponents differentiate their strategy from competitive energy suppliers as described below.

Most retail competitors are expected to offer primarily a single energy source and compete primarily on the basis of price. By contrast, the cooperative will feature value-added services designed to lower members' total energy bills. Bill savings will be achieved through competitive purchasing of energy and aggressive delivery of comprehensive energy-efficiency measures addressing all energy sources. The Consumer Energy Cooperative (CEC) will also lower bills by helping customers select the most cost-effective mix of energy sources for their individual energy service needs. CEC will offer its members the convenience of a single bill for all energy services.[51]

While the CEC states that it will target low-income customers with specific services that meet their needs, it will not focus exclusively on these customers, but seek a broad-based membership among residential customers. The CEC will seek to aggregate low-income customers through partnerships with existing community-based networks.

## A Note on the "Muni-Lite" Concept

Some municipal aggregation models closely resemble municipal power districts or rural electric cooperatives. However, there is a significant difference. Unlike traditional municipal utilities or cooperatives, a municipal aggregator does not seek to own or control the local distribution system; the poles and wires remain the property of the local distribution utility. But what if a town seeks to gain access to the wholesale market on behalf of its residents and compete with the local utility without any changes to the state's electric power laws? This is what Palm Springs, California, sought to do in 1996. The City of Palm Springs applied to the Federal

Energy Regulatory Commission (FERC) for approval to purchase wholesale power, which would then be transported to customers by the local utility, Southern California Edison (SoCal Edison). SoCal Edison opposed the proposal, arguing that residents were attempting to avoid paying state-approved retail rates which included costs not reflected in the wholesale market price. In August 1996, FERC denied Palm Springs' claim and stated that its attempt to establish ownership of the distribution system by purchasing duplicate meters was not enough to trigger its access to the wholesale market.

As a result of this ruling, it is now likely that municipalities cannot obtain access to the wholesale market and escape their current franchise utility unless the state restructures its retail service or moves to create a new municipal utility with all the rights and duties of such an entity. This latter option would then require the municipality to contract with the local utility for use of the distribution system already in place, or seek to obtain such property from the utility by eminent domain and pay its fair market value.